

## EXECUTIVE SECRETARIAT

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Remarks:

Executive Secretary

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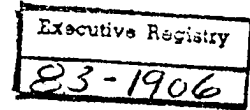
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OFFICE OF THE SECRETARY OF THE TREASURY

WASHINGTON, D.C. 20220

April 5, 1983




UNCLASSIFIED

MEMORANDUM FOR THE VICE PRESIDENT  
THE SECRETARY OF STATE  
THE SECRETARY OF DEFENSE  
THE SECRETARY OF AGRICULTURE  
THE SECRETARY OF COMMERCE  
THE DIRECTOR, OFFICE OF MANAGEMENT AND BUDGET  
CHAIRMAN, COUNCIL OF ECONOMIC ADVISORS  
ASSISTANT TO THE PRESIDENT FOR  
NATIONAL SECURITY AFFAIRS  
ASSISTANT TO THE PRESIDENT FOR POLICY DEVELOPMENT  
UNITED STATES TRADE REPRESENTATIVE  
~~DIRECTOR OF CENTRAL INTELLIGENCE~~

SUBJECT Senior Interdepartmental Group on International  
Economic Policy (SIG-IEP)

Attached are background papers on the Netherlands Antilles  
Tax Treaty and Helms Agricultural Trade Act for the April 7,  
1983, meeting of the SIG-IEP.

  
David E. Pickford  
Executive Secretary

Attachments

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Netherlands Antilles Tax Treaty

Attached are two background papers on the Netherlands Antilles Tax Treaty. The first provided by the Department of Treasury and the second by Norman Bailey.

### Netherlands Antilles Tax Treaty

A new tax treaty between the United States and the Netherlands Antilles has been under negotiation by the Treasury Department since 1980. The State Department has actively participated in all negotiating sessions, and there has been regular coordination with both State and the Justice Department. Although agreement in principle has been reached with the Antilles on many issues, several important issues remain unresolved.

A principal difficulty in reaching a new treaty with the Antilles has been the inability of the United States Government to speak with one voice during the negotiations. Negotiators for the Antilles appear to have been encouraged to continue to hold out for additional U.S. concessions, which has led the Antilles to reject prior proposals by the U.S. delegation and to delay responding to our most recent proposal (made 6 weeks ago). We have no indication from the Antilles that a U.S. concession on the issue of "derivative treaty benefits" would result in agreement on a treaty. In addition to this issue, which in itself involves at least three separate open points, no agreement has yet been reached on key aspects of the exchange of information provisions proposed by the United States, or on transition rules between the old and new treaties.

#### Background

Over the past 25 years, the Netherlands Antilles has exploited itself as a tax haven. This status has resulted largely because of a beneficial income tax treaty relationship with the United States. That treaty eliminates the U.S. statutory 30% tax on payments of interest and royalties to foreign investors, and it reduces to 15% (in some cases 5%) the U.S. statutory 30% tax on dividends paid to foreigners, if the payments are made to a resident of the Netherlands Antilles, which includes an Antilles corporation. Other U.S. tax benefits are also available under the treaty.

A primary use of the Netherlands Antilles is by residents of third countries who can minimize or totally avoid U.S. income tax that would otherwise be imposed on income from their U.S. investments and business operations. This avoidance is achieved simply by interposing an Antilles corporation between the ultimate foreign investor and the proposed investment, thereby permitting the Antilles entity to obtain U.S. tax advantages under the treaty between the United States and the Antilles.

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United States taxpayers have also utilized Antilles entities. The primary use has been to interpose an Antilles entity between a U.S. borrower and Euro lenders in an attempt to obtain access to the Eurobond market without the imposition of the statutory U.S. 30% tax on interest received by the lenders. Antilles entities have also been used by Americans for avoidance of U.S. and foreign income taxes, as well as for evasion of U.S. taxes (i.e., the illegal use of Antilles entities by U.S. persons to defraud the United States fisc).

In illustration of the growing use of the Antilles for access to the Eurobond market, there are approximately \$50 billion of outstanding Eurobonds of Antilles finance subsidiaries issued since 1974, of which about \$15 billion was issued in 1982. Interest payments from the United States to the Antilles, a jurisdiction of approximately 250,000 people, exceed by a substantial amount those made by the United States to any other single country, and indeed exceed the aggregate U.S. interest payments to Belgium, France, the Netherlands and the United Kingdom.

#### Goals of Negotiations

##### (a) Access to Capital Markets

The Administration has concluded that U.S. access to loan capital in foreign markets should be preserved at a minimal cost to the U.S. borrower. The most efficient route to such access would be through legislation to eliminate the 30% U.S. tax on interest paid to foreign lenders, and the Administration last year endorsed such legislation (the Conable-Cibbons bill).

Currently the Netherlands Antilles has a virtual monopoly on access to the Eurobond market by U.S. borrowers. This monopoly is a source of inefficiency in the worldwide capital market. The inefficiency arises from the cost of taxes and fees imposed by the Netherlands Antilles, from the increased administrative burdens and costs of awkward conduit arrangements, and from the present uncertainty surrounding the legal status of financing through the Netherlands Antilles. The Internal Revenue Service has, in the past two years, begun to audit a number of Netherlands Antilles structures utilized in conjunction with obtaining access to the Eurobond market. Under current law there is considerable doubt whether some of the financing arrangements through the Netherlands Antilles qualify for the treaty tax treatment. Where the foreign holder of a Eurobond relies solely on the

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obligation of a U.S. corporation, and the Antilles corporation is a mere conduit in a back-to-back financing arrangement, there is case authority saying that the existence of the conduit should be ignored for tax purposes. The result would, of course, be loss of treaty protection and the imposition of a 30% U.S. tax on interest payments from the U.S. corporation to the foreign bondholders, whether made directly or indirectly through the Antilles corporation.

Clearly, over the long term there is little reason to have U.S. access to the Eurobond market only through, or largely through, a monopoly such as the Netherlands Antilles. A far preferable alternative to ensure broad and easy access to the Eurobond market would be to eliminate the U.S. tax on interest received by foreign lenders. At least some greater efficiency would be gained by allowing U.S. firms a wider choice in their access routes, in particular allowing them to finance Eurobond offerings through financial intermediaries set up in other countries or U.S. possessions such as the Virgin Islands and Guam. While these methods might improve the efficiency of financing Eurobond offers, they would clearly adversely affect the Netherlands Antilles.

The key benefit needed by the Netherlands Antilles is retention of their monopoly status on Eurobonds. There is a direct conflict between supporting that monopoly status and seeking the most efficient financing method for U.S. firms. As is discussed below, the U.S. treaty position has attempted to compromise these two interests by providing for a temporary continuation of the Netherlands Antilles monopoly position in Eurobond offerings and in real estate investments. At the same time, we have provided for the possible termination of this special treatment of Eurobond interest at any time after 7 years if it is then in the U.S. interest to do so. This provision permits the Antilles to continue serving as an intermediary for financing operations for a number of years, during which time it can seek to develop alternative sources of revenues. At the same time, the treaty would achieve the U.S. goal of eliminating the present uncertainty surrounding Eurobond transactions by specifying in the treaty those conditions under which conduit arrangements would be acceptable, thus improving the efficiency of financing through Netherlands Antilles entities.

#### (b) Enforcement of U.S. Tax Law

The present treaty provides for exchange of tax information for tax enforcement purposes. The provisions, however, are limited; and, because of bank secrecy and the

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use of bearer shares in the Antilles, the IRS is unable to obtain much useful information for either civil or criminal tax cases. The Antilles has agreed in principle to broaden the exchange of information provisions substantially by piercing bank secrecy and bearer shares in some cases and providing information in a wide range of circumstances. Some significant issues relating to the exchange of information provisions remain, however, to be resolved.

(c) Bilateral Tax Reduction For U.S. Business

The purposes of U.S. tax treaties are twofold: (1) to prevent double taxation of income by the source country reducing its rate of tax on income derived by residents of the other contracting state, and (2) to prevent evasion or avoidance of taxes by providing for exchange of information and assistance between the contracting states.

In order that the United States not unilaterally reduce its tax imposed on foreigners without obtaining similar reductions of the foreign tax on Americans doing business or investing in a foreign country, it is the firm policy of the United States and of this Administration (strongly enunciated in Congressional testimony) to seek to prevent residents of third countries from benefiting from a treaty entered into between the United States and another country. This policy has been strongly supported by the tax-writing committees of Congress and by the Senate Foreign Relations Committee. In pursuit of this policy the United States recently terminated (effective January 1, 1982) our income tax treaty with the British Virgin Islands.

This policy is not based on revenue considerations. Its principal goal is to secure maximum foreign tax reductions for U.S. businesses and individuals deriving income overseas. The ability of third-country residents to use our existing Netherlands Antilles treaty has made it more difficult for the United States to conclude new treaties and to improve our existing treaties with the countries in which such persons are resident. If the residents of a country can obtain the full range of U.S. treaty benefits (i.e., U.S. tax reductions) without any need for their countries of residence to grant reciprocal tax reductions to U.S. businesses and individuals deriving income in that country, these countries have much less incentive to enter into or to renegotiate existing treaties with the United States.

Current Status of Negotiations

In the interest of reaching agreement on a new treaty with the Antilles, the present U.S. negotiating position would continue to allow U.S. tax benefits for a substantial

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volume of third country investment in the United States through Netherlands Antilles entities. All U.S. real estate investments made through Antilles entities, regardless of the country of the ultimate owner, would qualify for certain benefits. This in effect provides a monopoly position to the Antilles for such investments. In addition, certain third country residents would be able, through the Antilles treaty, to derive other U.S. treaty benefits, i.e. rate reductions on dividend, interest and royalty income. In this case, the benefits of the U.S.- Antilles treaty, so-called "derivative treaty benefits", would be available only if the benefits available under the home country treaty with the United States are as great as or greater than those available under the U.S.- Antilles treaty.

#### Congressional Considerations

There has been much Congressional interest in the Antilles treaty. Consultations with key Congressional staff members indicate that a new treaty with the Netherlands Antilles is unlikely to be ratified unless it effectively curbs third-country use and provides for full exchange of information.

If Congress does not ratify a new treaty, the adverse consequences both to our access to international capital markets and to the economy of the Netherlands Antilles are potentially severe.

In addition, the Subcommittee on Commerce, Consumer and Monetary Affairs of the House Committee on Government Operations, and the Permanent Subcommittee on Investigations of the Senate Committee on Governmental Affairs are both very interested in the use of the Netherlands Antilles to avoid and evade U.S. tax. Both Subcommittees have held hearings on the subject, and the House Subcommittee has scheduled a hearing for April 13, 1982, directed specifically to the Antilles tax treaty negotiations (see attachments).

#### Effect of U.S. Position on Antilles Economy

The Antilles claims that a new treaty reflecting the current U.S. position with respect to limitations on third country use would significantly harm its economy. These claims appear to be exaggerated. The present treaty, according to data provided by the Antilles Government, generates approximately 30 percent of the revenues of the Antilles Government. Approximately 70 percent of that amount is derived from Eurobond financing transactions. As explained above, this business will not be adversely



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affected and, in fact, is likely to expand as a result of the increased certainty which would be provided under the new treaty. The real estate business, the second largest source of revenue to the Antilles under the present treaty, will be preserved because the U.S. proposal will not restrict third country use of the treaty for real estate companies. In addition to Eurodollars and real estate, other uses by third country residents will continue, but not to the extent sought by the Antilles. Thus, it is difficult to understand how the U.S. proposals would cost the Antilles more than a very small percentage of their current revenues.

Approved by: John F. Chapoton  
Assistant Secretary (Tax Policy)  
Department of the Treasury

March 29, 1983